RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Aug. 22, 1990 **LETTER 1050**

Aug. 10 DJIA 2716.58; PTI 3255; A-D Ratio -12.60
Aug. 17 DJIA 2644.80; PTI 3249; A-D Ratio -13.38
Dow Yield: 4.10%; Dow P/E: 12.7; DowPow: -292
Dow Book Value: 1276; Dow 200-day MA: 2743
Percentage of Undervalued Blue-chips: 25%
PTI 89-day Moving Average: 3263

THE PICTURE: Question: Russell, from the standpoint of the primary bear market, what does the Iraqi takeover of Kuwait mean?

Answer: Well, I'll tell you one thing it means. It means that Washington's politicians are "off the hook" for another six months to a year. Forgotten are the billion-dollars-a-day federal deficits, simmering down is the necessity of cutting military expenses (or any other expenses for that matter), forgotten or almost forgotten is the spiraling cost of the S&L bailout, forgotten is a gas tax. So it's, "Thank you, Saddam Hussein," as far as Washington is concerned. If the nation sinks into recession, if things come apart at the seams, the politicians will just say, "Blame it on Hussein, we didn't do it."

Question: How about Iraq and the stock market? What's the relationship there?

Answer: A primary bear market was signaled under Dow Theory on January 25, 1990. I wrote at the time that "the bull market is over," and I've repeated that statement and re-emphasized it ever since. It's important to remember that both primary bull and primary bear markets end in only one way -- exhaustion. By exhaustion, I mean this -- a bull market will die when the last buyer has spent his money. A bear market will die when the last seller has dumped his stocks.

As far as the Iraqi situation changing the dynamics of this bear market -- the answer is no, the Iraq-Kuwait mess will not change the market dynamics. But it is certainly possible that the Iraq situation will alter the duration and the extent of the bear market.

Exactly how Iraq will change the duration and extent of the bear market, we don't know. But here's my guess based on past experience -- the Iraqi situation will extend the bear market and drive it lower than would otherwise have been the case.

The reason: Every disaster must eventually end. This being the case, the market will spend a good deal of time discounting the Iraq situation, probably dropping more during the course of the Iraq/US confrontation than it would have if Hussein had not overrun Kuwait. Then, when it looks as though the situation is clearing up, the market will rally and this will take up a good deal more time.

All of this rallying and declining will take place within the context of the larger primary bear market. In other words, the Iraq/US drama with its ups and downs -- will take place within the larger context of a major bear market. In this way, the bear market will be extended.

But the really important thing to remember is that this is a bear market, it is basically a liquidating market, and it's a bear market that, in my opinion, still has a long way to go.

Question: How long could this bear market last and how far down could it take the Averages?

Answer: The answer to that question can only be in the form of an educated guess, but first let me state that what bothers me most about the situation is this -- a bear market exists to correct the excesses of the preceding bull market. And we know that a mountain of excesses have been built into this market since December 1974 (I consider that the date when the great bull market started).

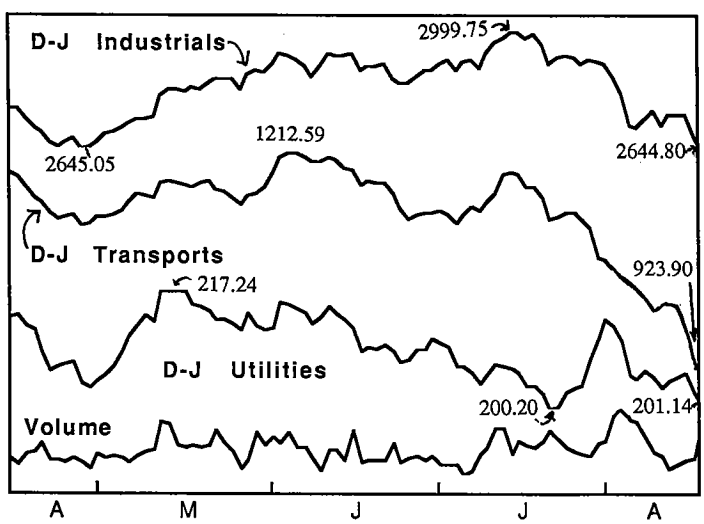
The bull market of 1974-89 lasted for 15 years and took the Dow from a low of 577 to a peak of 3000, a rise of 2423 points. Most bear markets correct (erase) at least half of the preceding bull market advance. If this bear market were to run true to form, in other words to erase at least half of the preceding bull market gains, the Dow would decline to a level of 1788.

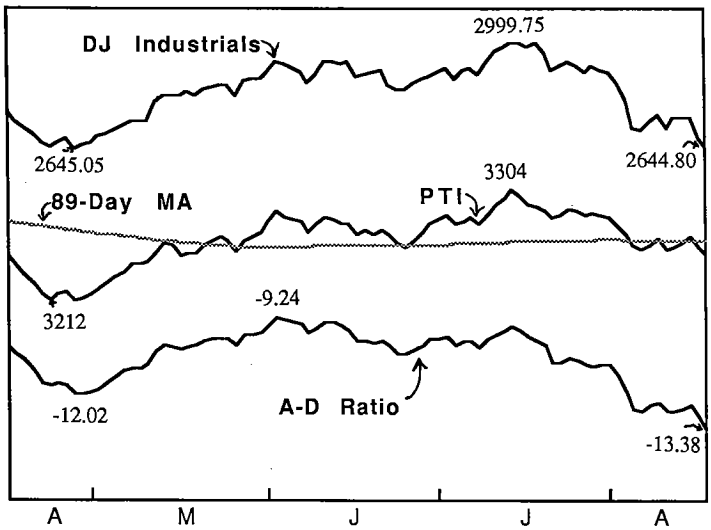
Question: What about the Dow on a valuation basis?

Answer: One of the few useful considerations in estimating the possible high or low of a bull or a bear market is the yield factor. Historically, the Dow has been overpriced when its yield has dropped to around the 3% level. Historically, the Dow has been a bargain when its yield has risen to around the 6% level.

Of course, this is no hard and fast rule, and in extreme situations, yields can push considerably further in either direction. For instance, in 1987, the yield on the Dow sank to 2.58%, at which time the market was terribly overvalued (this was one of the factors which led to the '87 crash). In 1932, at the bottom of the worst bear market in history, the Dow provided a huge yield of over 10% -- that was with the Dow at an incredibly low level of 41. The Dow has never been that low again.

Based on the current total Dow dividend of $104.75, if the Dow was to advance to the point where it provided a yield of only 3%, the Dow would sell at a value of 3492. Conversely, if, during this bear market, the Dow was to decline to the point where it provided a dividend yield of 6%, the Dow would have to drop to 1746. But be careful -- we have to remember that during the course of a bear market, many dividends will be cut. If some of the Dow stocks cut their dividends, the Dow would have to sell well below 1746 in order to provide a dividend of 6%.





So on a 50% correction basis, the Dow could drop to 1788. And on a bear market valuation of a 6% yield, the Dow could drop to 1746. The two numbers (probably coincidentally) are only 42 Dow points apart. Will the bear market eventually take the Dow down to the 1700s? It's certainly possible, but remember that those are simply theoretical levels, and to see where this bear market eventually ends, we'll have to await events and the whims of the bear.

Question: What about the timing of the bear market?

Answer: As to timing, again most bear markets last around one-third as long as the preceding bull market. Considering that the preceding bull market lasted 15 years, I would guess that this bear market could last anywhere from three to five years (certainly, the tops seems to have lasted forever). I take this bear market as having started last September 6 -- that was the date of the last confirmed highs (i.e. simultaneous new highs) of the D-J Industrial and Transportation Averages.

Note: My old friend, Joe Granville, has been on a roll for the past few years. In his latest letter, Joe states that he expects this bear market to last until April of 1992. He also thinks the Dow will ultimately test its 1987 crash low at 1738. I'm not sure how Joe arrives at his calculations, but I wouldn't disagree with his conclusions.

Question: How will Iraq/Kuwait affect the US federal budget?

Answer: I think it will knock it into a cocked hat. In meetings with Mr. Bush before the Iraqi attack on Kuwait, the politicians got absolutely nowhere on the budget talks. In fact, so little progress was made that the parties decided to put the budget talks off until September (with the hard decisions put off preferably until after elections in November). Last week, Mr. Bush, sounding desperate, berated the Dems for stalling and generally sabotaging the budget talks. The Dems reportedly were shocked by the Bush accusations.

The US could be moving up to 150,000 or more men into Saudi Arabia along with a massive naval task force, plus Air Force planes and supplies. With huge new military expenses, the whole subject of deficit reduction will fade away as a priority. Thus, I see the federal deficit spiraling off into space in the coming fiscal year.

Question: If you're correct in your budget deficit assessment, how will this affect the markets?

Answer: As I see it, the looming new budget deficits are putting steady pressure on both the dollar and the bond markets. And if that's true, sliding bond prices will also exert a continuing negative force on the stock market. Even if Hussein were to pull out of Kuwait tomorrow, the new perception of danger in the Middle East will remain, and there will be political pressure to save military programs that might have otherwise been cut.

Question: Russell, you've presented a very negative picture of events. But if you were the President or had his political clout, what would you be doing to end the bear market?

Answer: First, a quick discussion of how the primary trend works. Once a bull market has reached its peak, once it has discounted the BEST that can be seen ahead, at that point a bear market begins. Unfortunately, there's no way of changing that progression. And once a bear market starts, it's in the nature of things for the market to decline until the worst that can be seen ahead is fully discounted in the Averages. Government can manipulate the way the bear market progresses, but nothing government can do can change the final result. Ultimately, the bear will have his way.

That's a fundamental process that few people seem to understand -- or few people want to understand. The reason for the stubborn disbelief is that the primary trend concept has an inevitability factor about it. And human beings, in their arrogance, like to think that they are not subject to immutable natural laws. They want to believe that by pressing this button, or by passing that law, a bear market can be shunted away -- ended. Sadly, I must report that it doesn't work that way.

So what the President or Congress or the Fed can do, is try to mitigate the bear market damage (of course, the best way to do that is to halt excesses and over-speculation during the preceding bull market). However, at this point that's like crying over spilled milk. We've already experienced unbelievable excesses during the bull market of the '80s. Those excesses are built into today's economy. So at this point there's a lot to correct, and it's the bear's job to correct it.

Therefore, what I'd do is start telling the American people the truth -- the truth about the deficits, the truth about the compounding effects of the deficits and what that will mean to future generations. I'd tell them that they've had a party for 15 years, and now it's pay-back time. I'd tell them that the nation is under-educated, drug-ridden, beset by racial prejudice, and unproductive in industry. I'd tell them the truth, and I'd tell them that we have to roll up our sleeves and get very competitive in the global world -- or we're going to slide as a world power, and I mean slide very far down.

Question: Russell, assuming what you say is true, where does one look for signs of US health or lack thereof?

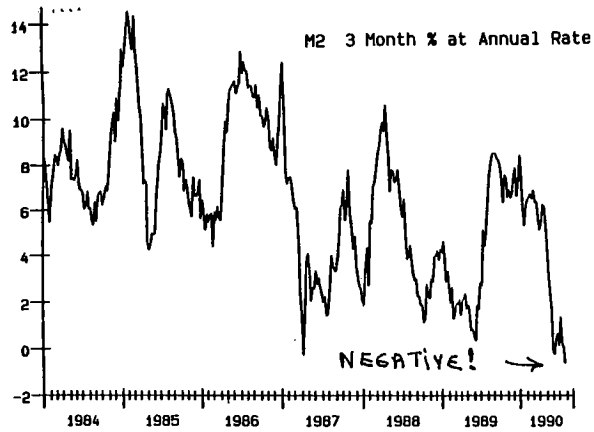
Answer: There are a number of barometers that should be watched. Obviously, one is the stock market. A second important barometer is the level of the trade-weighted dollar. A third is the dollar price of gold. A fourth is the price of a typical long-maturity Treasury bond.

The stock market, the dollar, and bonds have all been heading down -- and all are far below their recent highs. Gold (which tends to move counter to the other three) has been moving up. So on the basis of these four readings, the situation is hardly very bright.

Question: What do you see the Fed doing at this point?

Answer: In a word, "sweating." Pity the poor Fed. Under pressure from the Administration and out of fear of a recession, the Fed dropped the Fed Fund rate a minuscule 0.25 to 8%. The dollar immediately plunged, and then -- along comes Hussein. Oil explodes, bonds plunge, the dollar continues to weaken, and the nation is on the brink of recession (if it is not already in recession). So today, with a higher oil price being filtered through the economy, the Fed will probably wait (fear of inflation and a crashing dollar) before any further easing.

And to make matters worse (as this Ed Hyman, *CJ Lawrence* chart shows), the M-2 money supply has actually gone negative. A contracting money supply, by the way, is quite bearish, both for the economy and for stocks.

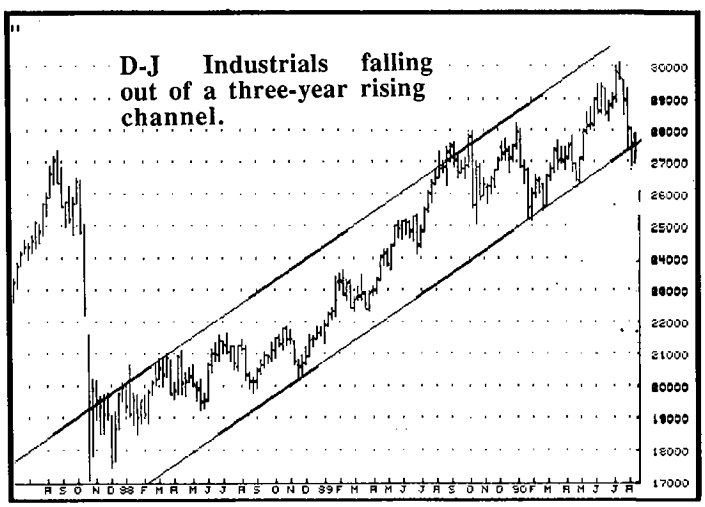


Question: Russell, do you see anything new or different in the market's price action?

Answer: Yes, two items. First, I note that some of my market indicators are over-sold, and they have been over-sold for quite some time. This is bear market action. When the bear is in command, the market can go over-sold and STAY OVER-SOLD for extended periods of time. This is contrary to what occurs in a bull market. In a bull market, once the market becomes over-sold, you can expect a rally to develop almost immediately.

The second item concerns the Dow. Note on this weekly chart (chart courtesy of *M.J. Capital,* Great Neck, NY) that the Dow has now violated its lower channel line, a trendline that has held intact ever since the 1987 crash. Note also that the Dow failed on its preceding rally to make contact with the upper limits of the channel -- always a sign of weakness.

I would take any plunge decisively below 2700 on the Dow as a very bearish indication. The reason why is easy to see on this chart.



Question: Is there anything hopeful about the market action?

Answer: Yes, a few items, and they are items that I have talked about before. For one, the Dow Directional Index (DDI) has not yet formed a downtrend. This bear market will not move into high gear until a downtrend does develop in the DDI (see last Letter for explanation of this Index).

Next, the Most Active Stock Index has not yet traced out a decisive downtrend. This Index is merely an advance-decline line of the plurality of the 15 most active stocks (daily) on the NYSE. In a bear market, I would expect a plurality of the most active stocks to head down each day. The bear market will not go into high gear until this Index heads down in earnest.

Finally, my Primary Trend Index (PTI) has been bouncing up, down, and around its 89-day moving average (see chart, page 2). But it has not yet sunk into the long, persistent downtrend which has been a feature of other bear markets. So all in all, I've got to say that the action of the PTI here is about as strange and erratic as any I've seen in 20 years of following this index. Nevertheless, the action of the market itself has certainly been strange and erratic, so why blame the PTI -- it'smerely reflecting what the market's doing.

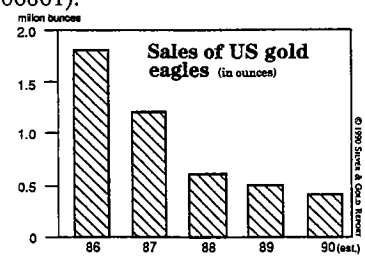
INVESTMENT POSITION: It's worth spending an hour or so running through a NYSE (or an Amex or NASDAQ) chart book. The market carnage is becoming painfully visible. Stock after stock has collapsed. The losses are spreading throughout the lists -- and growing. The advance-decline on the NYSE is at the lows, the A-D lines on the Amex and NASDAQ have completely collapsed. The voices of those who have argued, "it isn't really a bear market," have grown softer. Even the most stubborn of bulls are showing white knuckles.

The bear is master of the box. I've been writing my head off for many, many months about the US' compounding, out-of-control debts and what those debts will mean for the dollar. I guess someone's been listening. Last week, the dollar dropped to an all-time, 42-year low against the German mark. And the Dollar Index plunged to a new low.

So what don't I like here? Stocks and bonds and the dollar. What do I like here? Swiss francs, German marks (although at this point I prefer the Swissies), gold and gold stocks including Placer Dome, American Barrick, Anglo American ADRs.

And of course I continue to advocate monthly fixed-dollar purchases of bullion gold coins -- Krugerrands, American Eagles, Coronas, Maple Leafs.

As an aside, this chart shows sales of the once- popular US gold Eagles. As you can see, buyers have become increasingly discouraged. That's the kind of sentiment we like as a new bull market gets started -- discouragement, disinterest, a sold-out market for gold (chart courtesy of *Silver and Gold Report,* Box 510, Bethel, CT 06801).

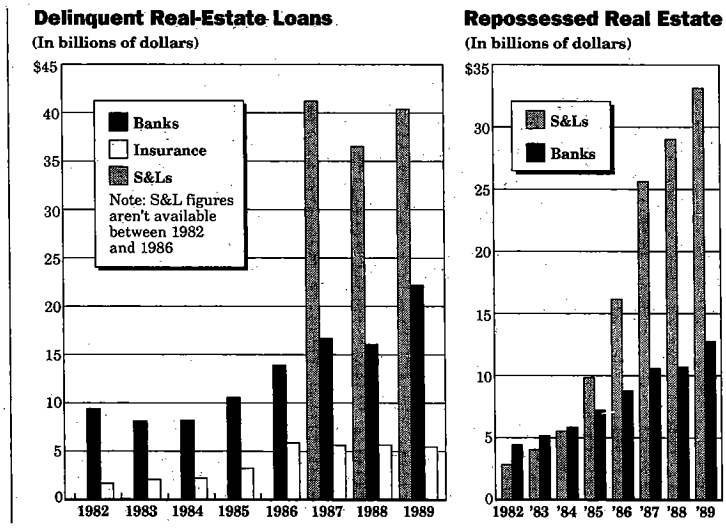


NOTES and QUOTES: A banking crisis may be the next fiasco on the bear market agenda. The 13,000 commercial banks have deposits of $3 trillion, three times the amount of the S&Ls. Since 1986, the commercial banks have written off $75 billion in bad loans -- all this while the economy was still strong and a bull market was in force. Now the insuring agency, the FDIC has taken its first loss ever and has a record low of only 70 cents in assets for every $100 it has to insure. The commercial banks now have $150 billion invested in merger and buyout loans and $400 billion in risky commercial real estate.

* *

If the bear market sinks its teeth into US real estate, many banks are going to be pressed to the wall. On August 10, the *WSJ* put out a special Real Estate section. The front page headline was as follows: "No End in Sight. It wasn't that long ago that people

talked about real estate as a 'sure thing' -- an investment that couldn't lose. What happened? Too much money, too much greed, too much optimism -- and bad government policy. What's ahead? More hard times." These two charts were included in the article. The black bars indicate bank real estate loans (first chart) and bank repossession of real estate (second chart). And remember, all this has occurred within the context of a primary bull market. But that's changed -- and the bear is in command.



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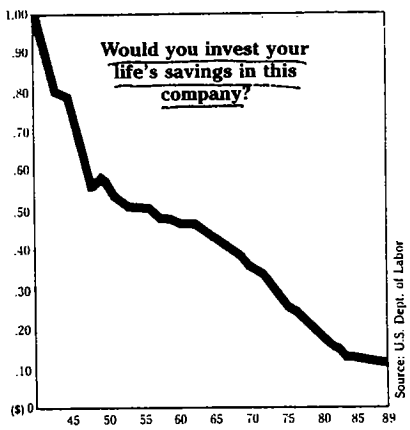
The collapse of the dollar means a lower standard of living for Americans in that our dollars buy less in the way of imported goods (and what do you buy that isn't imported?). But the cheaper dollar will help out exports, won't it? Yes, assuming foreigners continue to buy our exports. The problem here is that I expect this "economic contraction" to be worldwide, which means that foreigners will cut back on their buying of goods, American and otherwise. Thus, I see the falling dollar as a disaster, not an asset. One caveat -- the dollar should be getting oversold. If so, somewhere along the line we could get a technical rally .

* *

I've been talking my head off about the weak dollar, but remember the old song, "It ain't what you say, it's the way you say it." Along those lines, I just pulled this little chart from my friend Ken Gammage's market letter, *The Richland Report* (P.O. Box 222, La Jolla, CA 92038).



"Of course not! So why are your savings in dollars? This chart is the dollar. It shows—according to actual government statistics—the brutal effect of 45 years of systematic debasement of the dollar."

- - Dr. Franz Pick

* *

We're probably going to hear less and less about Mr. Gorbachev. The reason is that Gorby has the title now but it looks increasingly like Boris Yeltsin has the power. Yeltsin has tremendous popular support and was elected to the republic's top politician position. Yeltsin is king in Russia itself, which has three-fourth s of the Soviet land and half its people. Yeltsin's popularity stems from his stubborn resistance to the Communist party plus his insistence that the Soviets abandon Marxism. After only two months in office, Yeltsin has already overshadowed Gorby by producing a plan that calls for a confederation of sovereign states, leaving almost all control to the onetime republics except for common defense. Gorby will probably have to go along with the plan. Gorby now lacks public support, and his economic ideas are widely equated with abject failure.

* *

S&Ls: According to the latest *Forbes,* the government will pay outside lawyers $500 million to clean up the S&Ls. Michael Garner, writing in the August 9 *WSJ* , angrily notes that the cost of the Civil War was $7 billion, the cost of the Vietnam War, including benefits, was $172 billion, the entire cost of WWII, including service-connected benefits, was roughly $460 billion. But the cost of the S&L fiasco (which he terms "the biggest robbery in history") is upwards of $500 billion (some say $1 trillion when interest is figured in). Garner is angry and wonders why more people aren't angry. Russell comment: More people aren't angry because they've grown immune or numb to crime and government spending.

* *

Housing: New housing permits during the second quarter dropped 18% from a year ago as the nation's housing recession deepened. In the three biggest home-building states, Virginia, California and Florida, building permits caved in. In California, single family housing declines were: LA down 52%, Orange County down 46%, San Francisco Bay down 41%, San Diego down 26%.

* *

Great Predictions: Here's a beaut, from *Forbes,* August 21, 1920: "The first judgment of the automobile from a commercial point of view -- at least by bankers and businessmen outside the industry -- was that the auto was a rich man's toy, of which he might soon tire, and that, at best, its use would never extend beyond the 150,000 families whose incomes exceed $10,000."

* *

Trump's troubles continue to pile up. Merrill Lynch announced a few weeks ago that it is pulling out of Trump's restructuring effort. Meanwhile, Trump has $47 million in interest payments on $675 million in junk bonds that comes due on November 15. His legal bills are said to have hit $10 million on the negotiations. To make matters worse, the New Jersey Casino Control Commission disclosed last week (in an accounting document) that Trump could have a negative net worth of almost $300 million. By my definition, that's another way of saying that he's broke. I'll stick to my original prediction -- Trump will be history within a year.

* *

A bear market letter -- this from an op-ed letter in the August 7 *NY Times* by Hal Lux, writer for the *Investment Dealers' Digest* : "Two years ago when I graduated from business school, everyone wanted to be a corporate raider. Why get a first rate MBA if you couldn't acquire an industrial empire and a staggering debt loan by your 10th reunion? Now, with the junk bond market collapsed and hostile takeovers dead, not even a Phi Beta Kappa can line up decent leveraging financing. But if leveraged buyouts are no longer the ticket to a house in the Hamptons, many business and law school students think they see the next gravy train -- bankruptcy.

"Failure has never been so popular. Resumes are flooding into bankruptcy groups and to law firms and investment banks. Classes that train bankruptcy specialists are booked solid at leading graduate schools. Young professionals are betting that burying the corporate mistakes of the '80s will pay the rent into the '90s."

* *

Can a NFL team-owner buy his way into the Super Bowl? The Super Bowl winning 49ers have the highest payroll total in the NFL at $20 million. But the second highest payroll team at $19.5 million, the NY Jets, have one of the worst records in the league. You figure it out.

* *

States have increased their tax take by $7.6 billion so far in 1990. Taxes were raised by 23 states. Ten states increased personal income taxes, and 17 raised sales and use taxes. The biggest tax

increases occurred in Florida, Kentucky, Massachusetts, New Jersey, New York and Texas.

* *

Why did Hussein invade Kuwait. These are the reasons: (1) Iraq is broke, owes $80 billion in foreign debt. (2) Cost of Iraqi army is $7-10 billion year -- he needed money. (3) Iraq's sluggish economy is straining to absorb one million soldiers returning from the Iran war -- he needed to do something with the men. (4) Hussein faced oil-exporting neighbors to whom he owed billions and whose high-gear production in effect cut his own oil revenues. (5) The Arab world faces a leadership vacuum, and Hussein wants to fill that vacuum. (6) The Iraqi people were frustrated because there was no peace dividend following the costly war with Iran; they were also frustrated because Iran wouldn't return 70,000 prisoners of war. (7) In invading Kuwait, Hussein kept his army busy and renewed his people's pride in Hussein's "power." (8) And very important, in taking over Kuwait, Hussein was playing on the typical Arab's dislike of the fat, rich Arab monarchies as represented by Kuwait and Saudi Arabia. From the point of view of millions of poor Arabs, Hussein is their savior, defending them against the US and the West. These Arabs see the West as using the Arabs, siphoning off their oil at low prices, and in general working in cahoots with the Arabian monarchies. To these Arabs, Hussein presents himself as the savior, much as Hitler presented himself to the Germans during the early 1930s.

* *

They say that one of humanities saving graces is the ability to laugh at its own foibles. Then we have the S&L fiasco. Can anyone really laugh at this one? Here's one cartoonist that did, and I laughed with him.

THE WAR: C'mon, let's cut out the bunk. We're in an oil war. If Kuwait, for instance, was an African nation that had been overrun by another African nation, the news wouldn't even have made the front page of your local paper.

We're in a war-situation now, and as I see it, Hussein will go one of two ways -- he'll either wait the US out as long as he can, figuring that the110 degree heat and mounting expenses will melt the US will. Or he'll try to bring Israel into the war, knowing that the only item that can unite ALL Arabs is hatred of Israel.

My opinion: Even if the blockade results in Hussein pulling out of Kuwait (which I seriously doubt), Hussein will still be dictator of Iraq, and the danger will continue (and in a few years Hussein will have atom bombs). We've gone this far, and we might as well complete the job. I say knock Hussein out of the box, and fast, time's a'wastin' (of course, we won't do that).

In the meantime, Hussein has 1500 US hostages, the pressure will grow to do something, and we won't be doing anything but waiting. Waiting has never been the US' strength, and my guess is that the longer we wait, the less the US public is going to be enthralled with the situation (particularly, as the economy sinks into recession or stagflation).

CHANGING, MOVING: I know from my own experience how difficult it is to move, to make fundamental changes where investing is concerned.

When people spend most of their lives believing one thing, it's seemingly impossible to get them to see change, to see the other side of the coin. For instance, we have the folk lore about "America, the invincible, America, number one forever." Well, nothing's forever, and we might as well face it about America.

The fact is that the world is changing, and the trend as far as the US is concerned isn't terribly encouraging. Of course, trends do change, and I hope the current trend changes, but so far I don't see any hints of change. In fact, I see the trend becoming stronger. The trend I'm talking about is America's relative power and leadership in the world. Our power is declining -- I'm convinced of it.

From an investment point you can see it in the horrendous decline of the dollar relative to other currencies and relative to gold. I've said it many times before but I'll repeat it, "As the currency goes, so goes the nation."

But the problem for my subscribers and all investors is -- at what point do we do something about it? What can we do as far as the current trend is concerned? Well, the obvious course of action is to move at least part of our assets out of dollars and into non-dollar denominated items.

I realize that this is foreign territory for most investors. Most people aren't "comfortable" in gold and they aren't comfortable in foreign currencies. "Gad, I've grown up with the dollar, I pay my bills with dollars, my family has always lived via the dollar. What business have I in Swiss francs or Deutsche marks or some other "damn foreign currency"? As for gold, heck, the Fed, the Treasury and everyone else has always warned me against it. Didn't gold drop from 850 in 1980 down into the 300s? It's dangerous to hold non-interest paying gold, and it doesn't feel right to hold Swiss francs."

Yes, that's the attitude of the typical American. And it's the wrong attitude. It's an attitude based on past experience and a fear of strangers and a fear of foreign investment vehicles.

One thing I've learned in all these years of writing (and I've codified it) is what I call "Russell's Get Your Feet Wet Principle." And it goes like this -- when you see a new trend coming, even if you don't agree with it or even if you don't like it or even if you're suspicious of it -- GET YOUR FEET WET. In other words, buy at least a little of it.

Why? The answer is that once you get your feet wet, you start to get a feeling for the new trend, the new investment. And then if that investment starts moving up, you are in it, at least to some extent. You got your feet wet, and this gives you the courage to buy more.

That, by the way, is the reason why I've been telling subscribers lo these many months to buy gold and selected gold stocks and selected gold funds. I felt gold was basing, building a bull market bottom, and that it was important to get started, to have at least some sort of a position so we could add to that position if and when gold moved into a major bull market.

So all my subscribers at this point should have golden wet feet. Some of you have a few thousand dollars worth of gold items, some of you have hundreds of thousands of dollars worth of gold, but almost all of you should have at least some positions in gold purchased under (and in many cases well under) 400.

The same applies to the hard currencies. All of you should have some sort of investment in either Deutsche marks or Swiss francs. You should be getting your feet wet in the currencies. The position of the dollar is becoming increasingly precarious, and even though gold and the currencies may feel "foreign" to newer subscribers, you must learn to MOVE. Things change. Tidal trends change. The wealth of nations change. And we must learn to change with them. The first order of change is this -- when you see the trend

changing, don't argue with it, don't live in the past, move -- GET YOUR FEET WET.

GOLD: I don't want to sound arrogant, but I believe that the fund managers, the bankers, the trust managers, the pension managers, the stock and bond buyers -- they just don't see the big picture at all. Consider this: the gross US federal debt last week was $3.1897 trillion. Exactly one year ago the federal debt was $2.8171 trillion. That means that over the past twelve months, the total addition to the debt (this is the REAL, HONEST DEFICIT) was **$3.726 trillion** or $7.16 billion A WEEK! I mean this country is spending itself and borrowing itself into one unbelievable, out-of-control, frightening disaster.

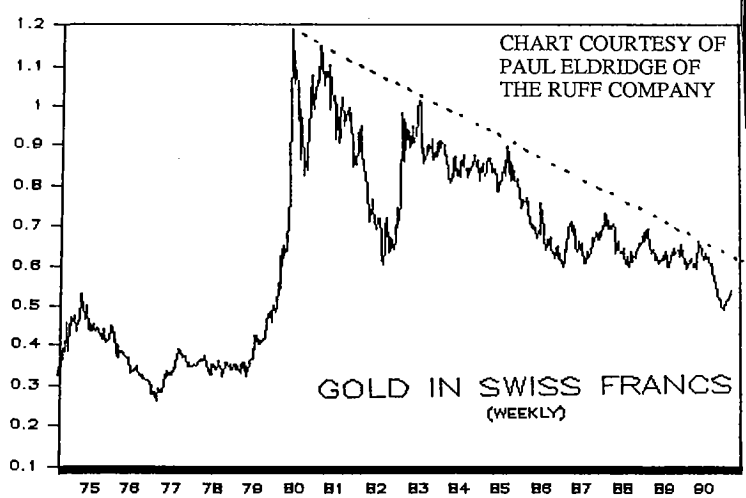
And people continue to talk down gold. Now consider this -- total world gold production is roughly $27 billion a year. That's equal to less than one month of US deficits (and don't forget, the rest of the world is producing deficits as well). Now all these deficits or debts (and they are compounding) must either be (1) paid off (forget all about this one), (2) extended, or (3) reneged on. But one way or the other, they must be financed. That means more paper, more promises, more lies, more and more debt.

Against this ever-increasing ocean of debt and new paper stands gold -- real money, intrinsic money, money with NO DEBT against it, money that doesn't need any government promises or guarantees.

Meanwhile, gold has been subject to a never-ending barrage of bad-mouthing -- from Washington, from the newspapers, from the analysts. "Gold pays no interest," "Gold is a barbaric relic," "The Arabs are selling gold," "Gold is headed for $150," and on and on.

The public is singularly disenchanted with gold. The American Eagle gold coins have shown fewer and fewer sales each year since it was issued. Sales of gold funds have dropped off. In short, gold today is "sold out."

Here's another phenomenon I've been watching. Gold in terms of the hard currencies has been falling for years. In fact, gold in terms of Swiss Francs (see chart) is down to its level of 1974 (16 years ago!), at which time gold was selling at $150 an ounce). In terms of the Swiss Franc or the German Mark or even the Yen, gold has been going down for 10 years. In my opinion, gold in terms of the dollar, the trade weighted dollar, or any of the "hard" currencies, is a bargain.



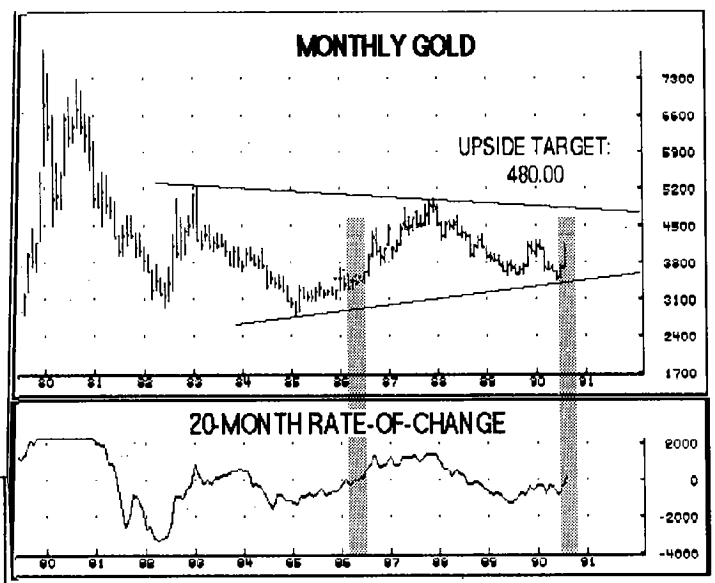
What about the Middle East crisis and gold? My feeling there is that all the Mideast is doing is worsening the background for the dollar and improving the fundamentals for gold. The estimates of the cost of the Mideast move for the US run about $4-5 billion and up (I'm inclined to think $10 billion and up). Iraq is another whopping expense tied on to the already outrageous US deficits. Let's face it - the US deficit has been out-of-control all along, and Hussein merely pulled the gold trigger.

By the way, note that NOBODY knows about or is talking about the $372 billion addition to the US deficit. You don't read about it anywhere (they're still talking about a $160 billion deficit). And now with the Middle East crisis, politicians are mouthing about a token $20 billion reduction in the federal deficit for 1991. But the fact is that all progress on deficit reduction is now being put off. These are the real fundamentals behind the gold move.

The real test of the dollar is how many dollars it takes to buy an ounce of gold. What we're watching today and what we've been watching is the systematic destruction of the dollar. As the dollar's value deteriorates, the price of gold in dollars rises.

The trade-weighted dollar is now breaking down. Looking at a chart going back to the '70s, I note that the dollar has now broken below a "supply line" connecting the 1979, 1981 and 1988 lows. This is trouble, pure and simple. The dollar is THE reserve currency, held by central banks around the world. To see the reserve currency collapse this way is shocking. It means that world liquidity (due to shrinking dollar value) is also contracting.

Price Action: This chart from *M.J Capital* shows all the (monthly) gold action going back to 1980. But now there's been a change. Writes *M.J. Capital* on a FAX received August 16, "As of last night the momentum data closed in positive territory for the first time since April, 1986 -- when nearby prices were around 335.00 on their way to the December 1987 peak of 502.30.



I feel now that the gold action is very constructive. Previously, when gold rallied,sellers came in and knocked it down. Now when gold declines, buyers come in and take it up.

In closing, don't think this gold action is based solely on Iraq. It's based on (1) US deficits, (2) the precarious position of the dollar, (3) the possibility of a global liquidity crisis.

LATE NOTES: The market is very oversold -- it's been oversold ever since July (but extended oversold conditions are a characteristic of primary bear markets). Meanwhile, the A-D ratio on the NYSE is down to its December, 1986, low, at which time the Dow was in the 1900s. DowPow has broken to a multi-year low. The 5-day moving average of new lows is 148, while the 5-day MA of new highs is 8 . . . There go the West Coast bank stocks -- B of A is down 18% from its December '89 close. First Interstate down 25%. Security Pacific down 25%. City National down 32%. Imperial Bancorp down 32%. Bank of San Fran. down 30%. Calif. Rep. Bancorp down 37%. Nat. Merc. Bancorp down 32%. So what's all this telling us about California real estate? Aw, what does the market know!